Constitution of the State of Illinois

ARTICLE VII

LOCAL GOVERNMENT

SECTION 1. MUNICIPALITIES AND UNITS OF LOCAL GOVERNMENT

"Municipalities" means cities, villages and incorporated towns. "Units of local government" means counties, municipalities, townships, special districts, and units, designated as units of local government by law, which exercise limited governmental powers or powers in respect to limited governmental subjects, but does not include school districts.

(Source: Illinois Constitution.)

SECTION 2. COUNTY TERRITORY, BOUNDARIES AND SEATS

(a) The General Assembly shall provide by law for the formation, consolidation, merger, division, and dissolution of counties, and for the transfer of territory between counties.

(b) County boundaries shall not be changed unless approved by referendum in each county affected.

(c) County seats shall not be changed unless approved by three-fifths of those voting on the question in a county-wide referendum.

(Source: Illinois Constitution.)

SECTION 3. COUNTY BOARDS

(a) A county board shall be elected in each county. The number of members of the county board shall be fixed by ordinance in each county within limitations provided by law.

(b) The General Assembly by law shall provide methods available to all counties for the election of county board members. No county, other than Cook County, may change its method of electing board members except as approved by county-wide referendum.

(c) Members of the Cook County Board shall be elected from two districts, Chicago and that part of Cook County outside Chicago, unless (1) a different method of election is approved by a majority of votes cast in each of the two districts in a county-wide referendum or (2) the Cook County Board by ordinance divides the county into single member districts from which members of the County Board resident in each district are elected. If a different method of election is adopted pursuant to option (1) the method of election may thereafter be altered only pursuant to option (2) or by county-wide referendum. A different method of election may be adopted pursuant to option (2) only once and the method of election may thereafter be altered only by county-wide referendum.

(Source: Illinois Constitution.)

SECTION 4. COUNTY OFFICERS

(a) Any county may elect a chief executive officer as provided by law. He shall have those duties and powers provided by law and those provided by county ordinance.

(b) The President of the Cook County Board shall be elected from the County at large and shall be the chief executive officer of the County. If authorized by county ordinance, a person seeking election as President of the Cook County Board may also seek election as a member of the Board.

(c) Each county shall elect a sheriff, county clerk and treasurer and may elect or appoint a coroner, recorder, assessor, auditor and such other officers as provided by law or by county ordinance. Except as changed pursuant to this Section, elected county officers shall be elected for terms of four years at general elections as provided by law. Any office may be created or eliminated and the terms of office and manner of selection changed by county-wide referendum. Offices other than sheriff, county clerk and treasurer may be eliminated and the terms of office and manner of selection changed by law. Offices other than sheriff, county clerk, treasurer, coroner, recorder, assessor and auditor may be eliminated and the terms of office and manner of selection changed by county ordinance.

(d) County officers shall have those duties, powers and functions provided by law and those provided by county ordinance. County officers shall have the duties, powers or functions derived from common law or historical precedent unless altered by law or county ordinance.

(e) The county treasurer or the person designated to perform his functions may act as treasurer of any unit of local government and any school district in his county when requested by any such unit or school district and shall so act when required to do so by law.

(Source: Illinois Constitution.)

SECTION 5. TOWNSHIPS

The General Assembly shall provide by law for the formation of townships in any county when approved by county-wide referendum. Townships may be consolidated or merged, and one or more townships may be dissolved or divided, when approved by referendum in each township affected. All townships in a county may be dissolved when approved by a referendum in the total area in which township officers are elected.

(Source: Illinois Constitution.)

SECTION 6. POWERS OF HOME RULE UNITS

(a) A County which has a chief executive officer elected by the electors of the county and any municipality which has a population of more than 25,000 are home rule units. Other municipalities may elect by referendum to become home rule units. Except as limited by this Section, a home rule unit may exercise any power and perform any function pertaining to its government and affairs including, but not limited to, the power to regulate for the protection of the public health, safety, morals and welfare; to license; to tax; and to incur debt.

(b) A home rule unit by referendum may elect not to be a home rule unit.

(c) If a home rule county ordinance conflicts with an ordinance of a municipality, the municipal ordinance shall

prevail within its jurisdiction.

(d) A home rule unit does not have the power (1) to incur debt payable from ad valorem property tax receipts maturing more than 40 years from the time it is incurred or (2) to define and provide for the punishment of a felony.

(e) A home rule unit shall have only the power that the General Assembly may provide by law (1) to punish by imprisonment for more than six months or (2) to license for revenue or impose taxes upon or measured by income or earnings or upon occupations.

(f) A home rule unit shall have the power subject to approval by referendum to adopt, alter or repeal a form of government provided by law, except that the form of government of Cook County shall be subject to the provisions of Section 3 of this Article. A home rule municipality shall have the power to provide for its officers, their manner of selection and terms of office only as approved by referendum or as otherwise authorized by law. A home rule county shall have the power to provide for its officers, their manner of selection and terms of office in the manner set forth in Section 4 of this Article.

(g) The General Assembly by a law approved by the vote of three-fifths of the members elected to each house may deny or limit the power to tax and any other power or function of a home rule unit not exercised or performed by the State other than a power or function specified in subsection (l) of this section.

(h) The General Assembly may provide specifically by law for the exclusive exercise by the State of any power or function of a home rule unit other than a taxing power or a power or function specified in subsection (l) of this Section.

(i) Home rule units may exercise and perform concurrently with the State any power or function of a home rule unit to the extent that the General Assembly by law does not specifically limit the concurrent exercise or specifically declare the State's exercise to be exclusive.

(j) The General Assembly may limit by law the amount of debt which home rule counties may incur and may limit by law approved by three-fifths of the members elected to each house the amount of debt, other than debt payable from ad valorem property tax receipts, which home rule municipalities may incur.

(k) The General Assembly may limit by law the amount and require referendum approval of debt to be incurred by home rule municipalities, payable from ad valorem property tax receipts, only in excess of the following percentages of the assessed value of its taxable property: (1) if its population is 500,000 or more, an aggregate of three percent; (2) if its population is more than 25,000 and less than 500,000, an aggregate of one percent; and (3) if its population is 25,000 or less, an aggregate of one-half percent. Indebtedness which is outstanding on the effective date of this Constitution or which is thereafter approved by referendum or assumed from another unit of local government shall not be included in the foregoing percentage amounts.

(l) The General Assembly may not deny or limit the power of home rule units (1) to make local improvements by special assessment and to exercise this power jointly with other counties and municipalities, and other classes of units of local government having that power on the effective date of this Constitution unless that power is subsequently denied by

law to any such other units of local government or (2) to levy or impose additional taxes upon areas within their boundaries in the manner provided by law for the provision of special services to those areas and for the payment of debt incurred in order to provide those special services.

(m) Powers and functions of home rule units shall be construed liberally.

(Source: Illinois Constitution.)

SECTION 7. COUNTIES AND MUNICIPALITIES OTHER THAN HOME RULE UNITS

Counties and municipalities which are not home rule units shall have only powers granted to them by law and the powers (1) to make local improvements by special assessment and to exercise this power jointly with other counties and municipalities, and other classes of units of local government having that power on the effective date of this Constitution unless that power is subsequently denied by law to any such other units of local government; (2) by referendum, to adopt, alter or repeal their forms of government provided by law; (3) in the case of municipalities, to provide by referendum for their officers, manner of selection and terms of office; (4) in the case of counties, to provide for their officers, manner of selection and terms of office as provided in Section 4 of this Article; (5) to incur debt except as limited by law and except that debt payable from ad valorem property tax receipts shall mature within 40 years from the time it is incurred; and (6) to levy or impose additional taxes upon areas within their boundaries in the manner provided by law for the provision of special services to those areas and for the payment of debt incurred in order to provide those special services.

(Source: Illinois Constitution.)

SECTION 8. POWERS AND OFFICERS OF SCHOOL DISTRICTS AND UNITS OF LOCAL GOVERNMENT OTHER THAN COUNTIES AND MUNICIPALITIES

Townships, school districts, special districts and units, designated by law as units of local government, which exercise limited governmental powers or powers in respect to limited governmental subjects shall have only powers granted by law. No law shall grant the power (1) to any of the foregoing units to incur debt payable from ad valorem property tax receipts maturing more than 40 years from the time it is incurred, or (2) to make improvements by special assessments to any of the foregoing classes of units which do not have that power on the effective date of this Constitution. The General Assembly shall provide by law for the selection of officers of the foregoing units, but the officers shall not be appointed by any person in the Judicial Branch.

(Source: Illinois Constitution.)

SECTION 9. SALARIES AND FEES

(a) Compensation of officers and employees and the office expenses of units of local government shall not be paid from fees collected. Fees may be collected as provided by law and by ordinance and shall be deposited upon receipt

with the treasurer of the unit. Fees shall not be based upon funds disbursed or collected, nor upon the levy or extension of taxes.

(b) An increase or decrease in the salary of an elected officer of any unit of local government shall not take effect during the term for which that officer is elected.

(Source: Illinois Constitution.)

SECTION 10. INTERGOVERNMENTAL COOPERATION

(a) Units of local government and school districts may contract or otherwise associate among themselves, with the State, with other states and their units of local government and school districts, and with the United States to obtain or share services and to exercise, combine, or transfer any power or function, in any manner not prohibited by law or by ordinance. Units of local government and school districts may contract and otherwise associate with individuals, associations, and corporations in any manner not prohibited by law or by ordinance. Participating units of government may use their credit, revenues, and other resources to pay costs and to service debt related to intergovernmental activities.

(b) Officers and employees of units of local government and school districts may participate in intergovernmental activities authorized by their units of government without relinquishing their offices or positions.

(c) The State shall encourage intergovernmental cooperation and use its technical and financial resources to assist intergovernmental activities.

(Source: Illinois Constitution.)

SECTION 11. INITIATIVE AND REFERENDUM

(a) Proposals for actions which are authorized by this Article or by law and which require approval by referendum may be initiated and submitted to the electors by resolution of the governing board of a unit of local government or by petition of electors in the manner provided by law.

(b) Referenda required by this Article shall be held at general elections, except as otherwise provided by law. Questions submitted to referendum shall be adopted if approved by a majority of those voting on the question unless a different requirement is specified in this Article.

(Source: Illinois Constitution.)

SECTION 12. IMPLEMENTATION OF GOVERNMENTAL CHANGES

The General Assembly shall provide by law for the transfer of assets, powers and functions, and for the payment of outstanding debt in connection with the formation, consolidation, merger, division, dissolution and change in the boundaries of units of local government.

(Source: Illinois Constitution.)

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MUNICIPALITIES
(65 ILCS 5/) Illinois Municipal Code.

(65 ILCS 5/Art. 8 Div. 5 heading)

DIVISION 5. DEBT LIMITS IN MUNICIPALITIES OF LESS THAN 500,000

(65 ILCS 5/8-5-1) (from Ch. 24, par. 8-5-1)

Sec. 8-5-1. Except as hereinafter provided in this Division 5, no municipality having a population of less than 500,000 shall become indebted in any manner or for any purpose, to an amount, including existing indebtedness in the aggregate exceeding 8.625% on the value of the taxable property therein, to be ascertained by the last assessment for state and county purposes, previous to the incurring of the indebtedness or, until January 1, 1983, if greater, the sum that is produced by multiplying the municipality's 1978 equalized assessed valuation by the debt limitation percentage in effect on January 1, 1979.

The indebtedness limitation set forth in this Section may be inapplicable to indebtedness incurred for the purpose of pumping water from Lake Michigan to one or more municipalities having a population of less than 500,000, whether before or after such indebtedness is incurred, if the majority of voters in such municipality approve such inapplicability at an election on the issue held in accordance with the general election law. The governing authority of any such municipality may, by proper ordinance or resolution, cause the proposition of the inapplicability of the limitation of indebtedness set forth in this Section to the indebtedness incurred for such purpose to be certified to the proper election authorities and submitted to the voters of the municipality at a regularly scheduled election in accordance with the general election law. If a majority of the votes cast on the proposition are in favor thereof, indebtedness incurred for the purpose of pumping water from Lake Michigan to one or more municipalities shall not be subject to the limitation set forth in this Section.

The indebtedness limitation set forth in this Section shall not apply to any indebtedness of any municipality incurred to finance the cost of the acquisition, construction or improvement of water or wastewater

treatment facilities mandated by an enforceable compliance schedule developed in connection with the federal Clean Water Act or a compliance order issued by the United States Environmental Protection Agency or the Illinois Pollution Control Board.

Any village or incorporated town may provide by resolution, and any city may provide by ordinance, for the taking of a census of the population thereof in order to determine the number of that population for any purpose of this Division 5. The courts in this state shall take judicial notice of the population of any municipality as it appears from the latest municipal census so taken. However, no municipal census shall be taken by the authority of this section, oftener than once in 3 years.

The amendatory Act of 1973 is not a limit upon any municipality which is a home rule unit.

(Source: P.A. 85-925.)

(65 ILCS 5/8-5-2) (from Ch. 24, par. 8-5-2)

Sec. 8-5-2. The limitation prescribed in Section 8-5-1 shall not apply to any indebtedness of any municipality incurred in connection with the issuance of funding bonds.

(Source: Laws 1961, p. 576.)

(65 ILCS 5/8-5-15) (from Ch. 24, par. 8-5-15)

Sec. 8-5-15. In a city or village having a population of less than 500,000, a petition, signed by electors of the city or village equal in number to not less than 10% of the number of votes cast for the candidates for mayor or president at the last preceding general municipal election at which a mayor or president was elected, may be presented to the corporate authorities of such a city or village asking that the question, whether that city or village shall incur additional indebtedness for the construction of impounding dams and artificial lakes for water supply purposes, together with the land and equipment necessary and incidental thereto, be submitted to the electors of that city or village. Thereupon, this question shall be certified by the clerk to the proper election authority and submitted at an election in accordance with the general election law.

This question shall be in substantially the following form:

Shall the city (or village) of.... incur additional indebtedness for the construction of impounding dams and artificial lakes for water supply purposes, together with the land and equipment necessary and incidental thereto?	YES
	NO

If a majority of the votes cast on this question are in the affirmative, the additional indebtedness for water supply purposes is approved.

(Source: P.A. 81-1489.)

(65 ILCS 5/8-5-16) (from Ch. 24, par. 8-5-16)

Sec. 8-5-16. The corporate authorities of any municipality which is not a home rule unit under the Constitution of 1970 are authorized to issue the bonds of such municipality without referendum subject to the limitation contained herein and the requirements of the Bond Issue Notification Act. Such bonds shall be payable from ad valorem tax receipts. The amount of such bonds, together with other bonds issued pursuant to this Section and outstanding, shall not exceed at the time of issue one-half of 1% of the assessed value of all of the taxable property located within the municipality.

Such bonds shall be authorized by a bond ordinance adopted by the

corporate authorities of the municipality. The bond ordinance shall make provision for the payment of the principal of and interest on the bonds by the levy of a direct annual irrepealable tax upon all of the taxable property within the municipality. A properly certified copy of the bond ordinance shall be filed in the office of the county clerk of each county in which any portion of the municipality is situated. Such county clerk or clerks shall extend the taxes levied in the bond ordinance for collection against all of the taxable property situated within the municipality. The taxes levied in the bond ordinance shall be extended annually by the county clerk or clerks without limitation as to rate or amount and such taxes shall be in addition to and in excess of all other taxes levied or authorized to be levied by the municipality.

Bonds heretofore or hereafter issued and outstanding which are approved by referendum, bonds issued under this Section which have been paid in full or for which provision for payment has been made by an irrevocable deposit of funds in an amount sufficient to pay the principal and interest on any such bonds to their respective maturity date, non-referendum bonds issued pursuant to other provisions of this Code, and bonded indebtedness assumed from another municipality, shall not operate to limit in any way the right of the municipality to issue its non-referendum bonds in accord with this Section.

(Source: P.A. 89-655, eff. 1-1-97.)

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ARTICLE 13.

Indebtedness.

Section 1. No political or municipal corporation in this State shall ever become indebted, in any manner or for any purpose to an amount, in the aggregate, exceeding two per centum on the value of the taxable property within such corporation, to be ascertained by the last assessment for State and county taxes, previous to the incurring of such indebtedness; and all bonds or obligations, in excess of such amount, given by such corporations, shall be void: *Provided,* That in time of war, foreign invasion, or other great public calamity, on petition of a majority of the property owners in number and value, within the limits of such corporation, the public authorities, in their discretion, may incur obligations necessary for the public protection and defense to such amount as may be requested in such petition.
(History: As Amended March 14, 1881).

Section. 2.
(History: Repealed March 14, 1881).

Section 3.
(History: Repealed March 14, 1881).

Section 4.
(History: Repealed March 14, 1881).

FEDERAL FUNDS
- Community Development Block Grants Program
- Water Quality and Wastewater Treatment Loans
- USDA Programs
- Other Federal Funding Programs

USER FEES

TAKING ADVANTAGE OF POPULATION GROWTH
- Special Census
- Special Tabulation

SOURCES OF REVENUE

City and town governments finance their activities primarily with money from nine major revenue sources:

- property taxes;
- taxes distributed by the county (other than local income taxes)s;
- municipal food and beverage taxes;
- local option income taxes;
- revenue distributed by the State;
- user fees and service charges;
- investment income;
- miscellaneous income; and
- debt funding.

This chapter will examine aspects of the first five categories. The other categories are discussed in other chapters.

PROPERTY TAX

Even though property tax on real and personal property is the primary source of revenue for Indiana cities and towns, there is a general lack of understanding with respect to how property is assessed and taxes are levied. Part of the blame for the lack of understanding lies with the pre-2002 true tax value property tax assessment system, which was not based on real world value (market value).

The 1998 Indiana Supreme Court decision, *State Board of Tax Commissioners v. Town of St. John*, 702 N.E.2d 1034 (Ind. 1998), required the state to adopt new regulations for the assessment of real property based on "objectively verifiable data." These new regulations went into effect for property tax assessments in 2002 for taxes payable in 2003. The second general reassessment since the Supreme Court's decision began July 1, 2010, and is to be completed by March 1, 2012, for property taxes first due and payable in 2013. Assessed values under the new system have a much greater correlation to market value than they did under the previous system.

Another reason for the lack of understanding is the general fund property tax levy controls that were adopted in 1973. The controls have been tweaked on an annual basis, but the general concept that was enacted in 1973 is in place today. The controls place a limit on the amount of general or operating fund property taxes that may be levied each year by cities and towns and all other units of local government.

Adding to this complexity is the number of deductions and exemptions authorized for various classes of property, some as a result of the use of the property (residential property), some as a result of some aspect of the owner of the real property (deductions for persons over 65, veterans', etc.)

The Property Tax Base

Property tax is imposed on the value of taxable property within the jurisdiction of a city or town. Not all property is taxable. State or federally-owned property is non-taxable (i.e., under law, it cannot be taxed, therefore, it is unnecessary for township assessors to assess the property). Property owned, occupied and used by a charitable, education, religious, scientific or literary organization is exempt from property taxes if the organiza-

tion properly applies for an exemption. Local officials sometimes refer to nontaxable property and tax exempt property interchangeably, even though legally, they are two different concepts. Neither the local courthouse nor the local post office can be taxed, therefore, it is not necessary for the local assessor to place an assessed value on either property. However, the local church can be taxed if it does not properly file an application for tax exemption, therefore, the township assessor should place an assessed value on the property, even though the church may file for an exemption.

In addition to tax exempt property, some property qualifies for an assessed value deduction. A deduction differs from an exemption, in that, only a portion of the value of the property is deducted, not the entire amount. There are several assessed value deductions, especially for homeowners (e.g., mortgage deduction, veteran's deduction, etc.). The most important deduction for homeowners is an assessed value deduction for persons who apply and qualify for the state's homestead credit. For property taxes first due and payable in 2012, the amount of the deduction is the lesser of $45,000 or 60% of the assessed value of the home. Since 2008, homesteads have also been eligible for a "supplemental" deduction equal to 35% of the home's assessed value for homesteads valued at not more than $600,000, and an additional 25% of assessed value greater than $600,000.

The property tax base of a city or town is the total assessed value of taxable property within the jurisdiction of the city or town, less assessed value deductions. Generally, the tax base consists of real property (land, buildings and other improvements) and personal property (business equipment and personal items, such as boat trailers and recreational vehicles that are not subject to an excise tax). The value of the property tax base is expressed in terms of dollars worth of assessed valuation. The value of the tax base before deductions is referred to as "gross assessed value" and the value after deductions is referred to as "net assessed value."

Cities and towns have no responsibility for determining the property tax base. That responsibility lies with township, county and state government officials. Township assessors are responsible for assessing real property, in accordance with rules approved by the Indiana Department of Local Government Finance (DLGF). Appeals of real property assessments may be taken to the county property tax assessment board of appeals (PTABOA) and the Indiana Board of Tax Review (IBTR). For personal property, taxpayers are responsible for filing annual personal property tax returns, which may be audited by township, county or state assessing officials.

The assessed value of land and structures is determined separately. Beginning with the 2012 general reassessment, county land value commissions are responsible for determining the market value of land. Under the Guidelines adopted by the DLGF, all residential structures, except for apartment complexes, are assessed based on their replacement value less depreciation factored by a neighborhood factor. The neighborhood factor is a fraction derived by dividing the total of the recent sale prices divided by the replacement cost less depreciation of those same properties. All other real property improvements are assessed based on their replacement cost less depreciation.

Real property is assessed periodically. The next general reassessment is scheduled to be completed in 2012 for taxes due in 2013. Subsequent general reassessments are scheduled to be completed every five years thereafter. The assessed value of real property has generally been adjusted on an annual basis beginning in 2006, for property taxes first payable in 2007.

Personal property, on the other hand, is self-assessed annually by the property owner, as is property of railroads and utilities. The bulk of taxable personal property in the tax base consists of machinery and furnishings of industrial and commercial enterprises. In more rural communities, the tax base is comprised largely of farm equipment, railroad or utility property.

Tax rates are set based on the amount of the assessed value in a jurisdiction. Each city and town sets its own tax rates based on statutory limitation. Within the statutory limitation, the larger the assessed value, the smaller the tax rate. Tax rates are of two types: the "unit" rate which is the rate imposed by a particular taxing unit (such as a city or town), and the "composite or "aggregate" rate which is the total of the unit rates to which the property is subject. Generally, property located in a city or township is subject a city or town tax rate, and also a township tax rate, a county tax rate, a library tax rate, and a school corporation tax rate.

The Levy

The term "levy" is one of the most confusing property tax terms. It is used as a verb to mean "to impose or levy a tax." It is also used to describe the amount of money collected from the property tax. The amount of tax collected by a city or town is considered the city or town's property tax levy. For purposes of this discussion, "levy" refers to the total dollar amount which is to be raised from property taxation by a city or town in a particular budget year.

Until the advent of property tax controls in 1973, the computation of the levy was simple: the municipality decided how much was needed and established a tax rate which, when applied to the assessed valuation, yielded that amount (levy). Since 1973, however, determining a municipality's property tax levy for any given year is an extremely complex process, as discussed below.

PROPERTY TAX CONTROLS

Nearly 40 years ago, in 1973, the Indiana General Assembly enacted a program to control the growth of property taxes in the state. The legislation restricted the amount of property tax that could be collected and subsidized the levies of the taxing units in the state by "replacing" a portion of the levy with state revenues from income or sales tax revenue. The property tax control program has been amended many times over the last 30+ years; the most significant amendments in recent years were enacted in 2008, including the elimination of the state replacement of a portion of the property tax levy. The present system of controls is quite different than that of 1973, although property tax revenues are still strictly limited.

Maximum Levy

The amount of property tax that a unit can collect each year in its controlled funds is limited by the establishment of a maximum property tax levy. Each year a new maximum levy is calculated, based on the levy from the previous year, multiplied by a statutory formula. The property tax controls are also referred to as the "maximum levy limitation" or the "property tax freeze."

Although the maximum levy for a municipality for the next year is calculated from a complex formula that defies simple description, the major factors can be described, and most municipalities can accurately estimate the maximum levy for the ensuing year. However, municipalities located in counties that have adopted a local option income tax have greater difficulty in estimating the maximum levy.

The current year's maximum levy is increased by a growth factor (AVGQ) to arrive at the maximum levy for the ensuing year. The present factor, set by law, is the six-year average growth in Indiana of non-farm income (IC 6-1.1-18.5-2; IC 6-1.1-18.5-3). If a municipal tax base (assessed valuation) is growing faster than the six-year average growth in Indiana non-farm income, a higher rate may be applied. Adjustments are also made to reflect the addition of assessed valuation as a result of annexation. The result, after these adjustments, is the maximum property tax levy for the next year. The municipality may impose a tax rate that will result in a levy up to, but not exceeding, that amount. The maximum levy is not necessarily the same as the actual levy since municipalities may be taxing at a lower rate than the law allows.

In certain instances a municipality may appeal to the DLGF for an "excess levy." Such an appeal is a request for permission to have a levy higher than the maximum levy calculated under the controls (IC 6-1.1-18.5-13). Levy appeals are authorized only for the following purposes:

- for increased costs resulting from annexation;
- for needs due to growth that is 2% greater than the average state wide growth quotient;
- if the civil taxing unit cannot carry out its governmental functions for an ensuing calendar year, due to a natural disaster, accident or other unanticipated emergency;
- for advertising error, mathematical error, or error in data made at the local level; and
- for levy shortfalls in the prior year caused by errors in assessed value and by taxpayer refunds.

Property taxes levied to pay debt service on general obligation bonds or to make payments under certain capital leases are outside the maximum levy limitations. For the most part, taxes levied for the Cumulative Capital Development Fund (CCDF) are also outside levy limits. The CCDF is a savings account for certain capital projects.

In addition to the levy controls placed on operating funds, state statutes also limit the amount of property taxes that can be levied for other purposes. Property taxes for debt service are limited by requiring cities and towns to subject certain projects funded by bonds or lease rentals to either a petition/remonstrance procedure or a referendum. Property taxes for cumulative building or capital funds (savings accounts) are limited by maximum property tax rates.

CIRCUIT BREAKER

Circuit Breaker Tax Credit

Circuit breaker tax credits, or property tax caps, limit the amount of taxes imposed on property by a predetermined percentage of the property's gross assessed value: 1% for homesteads; 2% for other residential property, certain long term care property and agricultural property; and 3% for all other real and personal property (IC 6-1.1-20.6).. As property tax bills are computed, they are compared to the tax caps and any resulting amount above the tax cap is deducted from the distribution of property taxes to all of the local units of government (and school corporations) in an amount proportional to that unit's percentage share of the tax levy.

Because the property tax caps absolutely limit the amount of property tax revenues to be paid by taxpayers, many communities have seen, and will continue to see, a reduction in revenues available to fund operations or to pay debt service or lease rentals. Political subdivisions, including municipalities, are mandated to pay debt service and lease rentals payable from debt service prior to any other expenditure, and a mechanism exists by which the Treasurer of State must intercept revenues that would otherwise be distributed to cities and towns to pay debt service on property tax based obligations if the Treasurer is notified that the local government has not paid such debt service or lease rentals (IC 6-1.1-20.6)..

LOCAL OPTION TAXES

In General

With the exception of certain municipal food and beverage taxes, municipalities have only limited authority to affect the imposition of local option taxes. Despite that, this information is important to municipalities as the plan for revenue streams in the future.

County Adjusted Gross Income Tax (CAGIT)

The County Adjusted Gross Income Tax ("CAGIT") (IC 6-3.5-1.1) was enacted in 1973 in conjunction with the 1973 property tax control program. From its inception, CAGIT has been intertwined with property tax relief and property tax calculations. CAGIT can only be imposed by the county council for a particular county. The tax rate is applied to the Indiana adjusted gross income, as defined in state law. The maximum CAGIT rate is 1%. Revenues are collected by the state through the income tax system (withholding and estimated tax procedures), and paid to the recipient county governments twice a year. The county auditor in turn is responsible for distributing the CAGIT revenue within the county.

All civil taxing units (counties, cities, towns, and townships) and school corporations in the county received a portion of CAGIT revenue as replacement for property taxes (replacement credits). All civil units of government, but not school corporations, receive an increasing amount of CAGIT revenues for additional revenue (certified shares). The philosophy of CAGIT remains unchanged since 1973. It is designed to change the tax mix with less reliance on property tax and more on income tax, and to retain strict limits on the overall revenue available.

County Option Income Tax (COIT)

Legislation allowing local governments to impose the County Option Income Tax ("COIT") (IC 6-3.5-6) was passed in 1984 in response to criticism of CAGIT as a source of new revenues. COIT revenues are completely separate from property tax calculations, are considered a separate source of revenue and may be used for any corporate purpose of the municipality. COIT cannot be imposed at the same time CAGIT is imposed, nor may CAGIT be imposed at the same time COIT is imposed (IC 6-3.5-6-8; IC 6-3.5-1.1-2). The maximum COIT rate is 1% of the taxpayer's Indiana adjusted gross income. Revenues are collected by the state through the income tax system (withholding and estimated tax procedures), and paid to the recipient county governments monthly. The county auditor is required to distribute COIT revenues to all civil taxing units in the county monthly. School corporation do not received COIT revenues.

The legislation creating COIT was designed to give municipal officials some voice in imposing the tax, unlike CAGIT, which is imposed by the county council. COIT can be imposed only by the County Income Tax Council. Each city and town in the county can vote on COIT by having the legislative body of the municipality pass a resolution casting its votes. The county council can cast the county government votes in a similar fashion. In each county, there are 100 votes which are divided among the cities and towns, according to the population within their corporate limits, and with the county's share of votes based on the number of individuals living in unincorporated areas.

County Economic Development Income Tax (CEDIT)

A third local income tax, authorized by legislation enacted in 1987, is the County Economic Development Income Tax ("CEDIT" or "EDIT") (IC 6-3.5-7). The original purpose of CEDIT was to provide a revenue source for capital projects and for facilities that were needed to attract or retain economic enterprises in the community. Legislation enacted in 2005 permits the use of CEDIT revenues for any purpose for which any funds of the municipality may legally be spent.

The maximum CEDIT rate is 0.5%. The combined CAGIT plus CEDIT rate cannot exceed 1.25%; the combined COIT plus CEDIT rate cannot exceed 1%. The tax base for CEDIT is identical to COIT and CAGIT and is collected in a similar fashion. The revenue is distributed to the county semiannually, and is not allocated among all taxing units, but only among the cities, towns and county governments. In addition, those units must have an approved capital improvement plan in place specifying the use of the funds before receiving any distribution from the county auditor.

The decision on the imposition of the CEDIT tax depends on the existence of other income taxes. In CAGIT counties, the county council can impose CEDIT. In COIT counties, the COIT council can impose CEDIT. In counties that have not imposed either CAGIT or COIT, either body may impose CEDIT.

County Motor Vehicle Excise Surtax and the County Wheel Tax

The wheel tax (IC 6-3.5-5) and motor vehicle excise surtax (IC 6-3.5-4) are imposed by the county, although a portion of the revenues are distributed to cities and towns. They are actually two different taxes, but almost always considered as one since state law requires that both taxes, if any, must be imposed; a county may not choose to impose only the surtax or only the excise surtax. The resulting revenues must be used on roads and streets.

The motor vehicle excise surtax is imposed on passenger cars and small trucks, the same vehicles that pay motor vehicle excise tax in lieu of property tax under Indiana law (IC 6-3.5-4). The surtax may be imposed either:

- at a rate of at least 2%, but not more than 10% of the state motor vehicle excise tax (based upon the pre-1990 rate schedule for the state motor vehicle excise tax), but with a minimum fee of $7.50; or
- at a specific amount of at least $7.50, but not more than $25.00 (IC 6-3.5-4-2).

The wheel tax, which must be imposed with the excise tax, applies to vehicles which do not pay the motor vehicle excise tax. This includes vehicles such as trucks, buses, and trailers. The statutes establish five general classes of such vehicles, and each class may have an individual rate of no less than $5 and no more than $40. In some cases, subclasses can also be established using weight classifications and different rates imposed for the subclasses.

LOITS

County Levy Growth Replacement Income Tax

In 2007, the General Assembly authorized the imposition of three additional countywide local income taxes, commonly referred to as "LOITS," in order to encourage local governments to lessen their dependence on property taxes. The LOITS are simply an additional rate of either CAGIT or COIT. If the county has already imposed CAGIT, the additional rate is a CAGIT rate, and is imposed in the same way CAGIT is imposed. If the county has already imposed COIT, then the additional rate is a COIT rate, and is imposed in the same manner as is COIT.

The first of these LOITs was an additional county income tax rate to fund the growth in property tax levies of all taxing units in the county for the ensuing two years (as opposed to generating the levy growth with increased property taxes The maximum rate at which the replacement rate may be imposed is 1%, although the actual rate to be imposed is determined by the DLGF and the Department of Revenue and provided to the county. The rate to be imposed in the first year should be sufficient to generate twice the amount of revenue needed to fund the growth in the levy for that year. 50% of the revenues must be deposited in a revenue stabilization fund, held at the county level, to provide revenues if in a subsequent year, the income tax revenues are not sufficient to fund the required levy growth amount. In the second year, the income tax rate is reduced to generate only the amount of revenues sufficient to generate the levy growth replacement amount. The levy growth replacement rate may not be rescinded or reduced, although it may be increased in subsequent years. The amount distributed to each taxing unit is the amount of the growth in the unit's levy, as determined by the DLGF and the Department of

Revenue (not the AVGQ determined for growth in property taxes). If the county imposes the replacement rate, all controlled levies in the county are frozen at the previous year's amount.

County Property Tax Relief Income Tax

The second LOIT authorized in 2007 was an additional income tax rate to provide direct property tax relief. If the county has already imposed CAGIT, the additional rate is a CAGIT rate, and is imposed in the same way CAGIT is imposed. The replacement rate may be imposed in increments of .05%, up to a maximum of 1%.

The county may authorize any of the following forms of property tax relief (or any combination):

- uniform property tax replacement credit, applicable to all types of property;
- homestead credit, applicable to homesteads only;
- residential property credit, applicable to homesteads, apartments, and residential rental property.

These revenues are treated as part of the civil taxing unit's property tax levy for the ensuing year.

County Public Safety Income Tax

The third LOIT enacted in 2007 authorized counties that have imposed either that levy growth replacement rate or the property tax relief rate (or both) at a rate of at least 0.25% to impose an additional income tax rate to provide funds for public safety costs. The public safety rate may not exceed the lesser of the rate (or combined rate) of the first two LOITs or 0.25%.

The definition of public safety is extremely broad, virtually every operating expense for public safety, courts and criminal corrections are eligible purposes. The revenues are to be distributed to each municipality that provides public safety services and to the county. In addition, a fire department, volunteer fire department, or emergency medical services provider that provides fire protection or emergency medical services within the county and is operated by or serves a political subdivision that is not otherwise entitled to receive a distribution, may request a distribution of public safety LOIT from the county council, to be funded from the public safety LOIT revenues prior to distribution to the municipalities.

Municipal Food and Beverage Taxes

Nearly a dozen municipalities have statutory authority to impose a municipal food and beverage tax. Among these are Nashville (IC 6-9-24), Shipshewana, Mooresville, Plainfield, Brownsburg and Martinsville (IC 6-9-27), and Carmel, Fishers, Greenfield, Lebanon, Noblesville, Westfield and Zionsville (IC 6-9-35). There is no general authority permitting any other municipality to impose a food and beverage tax.

STATE-DISTRIBUTED MONIES

Cities and towns share in certain revenues from the state in the form of state-collected taxes, licenses and fees. These dollars are distributed on a formula basis and with some exceptions must be used for specific purposes.

Motor Vehicle Excise Tax

Indiana imposes a motor vehicle excise tax on all motor vehicles in lieu of a personal property tax (IC 6-6-5). The receipts from the tax on each vehicle are distributed to the taxing unit where the owner of the vehicle resides, and within each taxing unit among the various funds in the proportion that the property taxes are distributed. This is done at the same time property taxes are distributed in June and December of each year. A similar tax is imposed on recreational vehicles and truck campers (IC 6-6-5.1), commercial vehicles (IC 6-6-5.5), aircraft (IC 6-6-6.5) and boats (IC 6-6-11); revenues are distributed in the same matter as the motor vehicle excise tax revenues are distributed. In 1995, the General Assembly reduced the rate of the automobile excise tax (and thus the revenues), by up to 50% for most automobiles. Most, but not all, revenues lost by local governments as a result of that rate reduction are replaced by revenues generated from state lottery and gaming activities.

Financial Institutions Tax

Since 1933, financial institutions (banks, savings and loans, etc.) have been subject to a tax, part of which is distributed to local units of government. Financial institutions are taxed on the basis of their federal adjusted income, subject to certain reductions; financial institutions also pay personal property taxes (IC 6-5.5). Revenues are distributed quarterly to each county, and the county is in turn responsible for making distributions

CHAPTER 11
DEBT FINANCING

IN THIS CHAPTER

LONG TERM DEBT

Cities and towns have several reasons for using long-term debt for financing municipal improvements. One of the primary reasons is because it is difficult for municipal governments to accumulate the large amounts of funds required for most capital improvement projects on a timely basis. Another reason is that these capital outlays normally benefit the public over a long period of time, and in a society whose citizens move frequently, it is felt that present taxpayers or ratepayers should not pay for benefits to be enjoyed in the future by people who presently are not taxpaying citizens of the community. Also, with rising costs, construction of projects may be

cheaper if undertaken when their need is first perceived rather than waiting until adequate funds can be accumulated. Another final consideration is that large expenditures for capital improvements may reduce the willingness or ability of taxpayers to pay taxes, or ratepayers to pay rates, to cover current necessary expenditures. Thus, long-term borrowing is a method of assuring that tax or similar burdens for capital improvements do not inhibit necessary current expenditures, provide funding for the outlay on a timely basis, and assure that those taxpayers benefiting from the improvement are paying for the improvement.

One added incentive municipalities have for using long term debt to finance capital improvement projects is that for most projects the interest the municipal government pays is exempt from federal income taxes. This means that the lender or bondholder does not have to pay federal income taxes on the interest earnings and therefore does not expect to earn as high a rate of return as would be expected on other types of loans or bonds. Consequently, the rate of interest the municipality pays is much lower than most other types of borrowing.

Legislative authority for municipalities and their political subdivisions to use long-term debt financing comes from several sources. Authority for local governments to borrow money is granted in IC 36-1-4-9 and general authority is given to municipalities and other political subdivisions to "issue any bonds, notes, or warrants that it considers necessary" by IC 6-1.1-20-2. Specific borrowing authority is found in numerous other statutes.

Municipalities are also granted the power to undertake long-term and temporary borrowings in other chapters of the Indiana Code (IC 36-3-4-21, IC 36-4-6-19 and 20). These loans are restricted to the "legitimate exercise of corporate power" of the municipality which has been interpreted to mean that the municipality must have some specific grant of authority. These statutes require that a common council pass an ordinance for such loans (i.e., bonds, notes, warrants or obligations) and also limit the length of the loans to maximum maturities of 30 years. However, bonds issued under these statutes that are payable in whole or in part from ad valorem property taxes are limited to a maximum maturity of 20 years. Town councils are given the general power to issue bonds under IC 36-5-2-11 with no apparent limitation on length of maturity. These loans are subject to the constitutional two per cent limitation discussed later in this section.

A common mechanism through which municipalities create long-term debt to finance municipal improvements is through the issuance of bonds. When a municipality issues long-term debt it generally dedicates a specific future revenue source to repay that debt. Some of the revenue sources a municipality can dedicate include property taxes, income taxes, utility revenues and special assessments. Frequently, a municipality will use two or more of these revenue sources to support a financing.

General Obligation Bonds

General obligation bonds are the most traditional form of debt and pledge the full credit and property taxing power of the municipality or political subdivision. The repayment of general obligation bonds is from ad valorem property taxes. They may be issued for financing any lawful purpose except the payment of current operating expenses (which may be financed by a temporary loan). Municipalities may issue general obligation bonds for any corporate purposes, including capital projects. In addition, a variety of statutes authorize long-term financing for specific purposes.

General obligation bonds have certain advantages and disadvantages. Because these bonds are generally viewed to be more secure than other types of bonds, their interest rates may be lower than for other types of financing. They also provide a relatively simple method for obtaining money because no additional work needs to be done in identifying and projecting revenue sources since the repayment will be made from a property tax rate outside the municipality's levy limitation.

A disadvantage of general obligation bonds lies in the lengthy procedures that must be followed and the risk that after the lengthy procedures, the bonds cannot ultimately be issued. The General Assembly has imposed strict procedural requirements on bond issues (including general obligation and special taxing district bonds) and leases issued to fund a "controlled project." Generally a controlled project is a project financed by bonds or a lease payable in whole or in part from ad valorem property taxes and the cost of the project, including funds on hand of the municipality, exceeds the lesser of (i) $2,000,000; or (ii) the greater of (a) one percent of the total gross assessed value of property within the municipality, or (b) $1,000,000. There are exceptions to the definition of controlled project set forth in IC 6-1.1-20-1.1. Bonds issued or leases entered into to fund a controlled project are subject to either the petition and remonstrance process or a referendum based on the total cost of the project.

<u>Petition and Remonstrance</u>. The threshold for application of the petition and remonstrance process is a project, the total cost of which exceeds the threshold described above for a controlled project, but is less than the lesser of (i) $12,000,000; or (ii) the greater of (a) one percent of the total gross assessed value of property within

the municipality, or (b) $1,000,000. If the financing for the project is subject to the petition and remonstrance process, taxpayers and registered voters may petition to invoke a remonstrance process wherein supporters and opponents circulate petitions simultaneously and the petitions containing the greater number of taxpayer and registered voters signatures prevails. The complicated nature of debt financing makes competent legal advice critical in this process.

Referendum. The threshold for application of the referendum process is a project, the total cost of which exceeds the lesser of (i) $12,000,000; or (ii) the greater of (a) one percent of the total gross assessed value of property within the municipality, or (b) $1,000,000. If the financing for the project is subject to referendum, taxpayers and registered voters may petition to invoke a referendum process wherein a public question whether to approve or not approve the financing is placed on a ballot during an election and the majority vote prevails.

The institution of the Circuit Breaker Tax Credit has also altered the nature of general obligation bonds issued by cities and towns since May 11, 2006. See, Circuit Breaker, Chapter 10. Cities and towns may no longer pledge unlimited ad valorem property taxes to the payment of debt service or lease rentals, because the application of the Circuit Breaker affirmatively limits the amount of property tax revenues a municipality has for all purposes, including the payment of debt service and lease rentals. While the Department of Local Government Finance has ruled that the first property tax revenues received must go to pay property tax based bonds, the financial markets no longer view these bonds as backed by an unlimited tax. As a result, this type of bond tends to have a higher interest cost than it did before the Circuit Breaker Tax Credit was enacted. In addition, many insurers of municipal bonds have also declined to insure Indiana municipal bonds since the institution of the Circuit Breaker. This has also impacted the interest costs of property tax based obligations.

Perhaps the most significant disadvantage of general obligation bonds is in the limitation in the amount of general obligation bonds a municipality can have outstanding. Indiana has a constitutional limitation that a municipality's or other political corporation's debt may not exceed two percent of its adjusted value of taxable property (Article XIII, Section 1, Indiana Constitution and IC 36-1-15). The adjusted value of taxable property is equal to one third of the net assessed value. With the increasing costs of capital improvements and the controlled growth in assessed valuation, it is apparent that few municipalities could provide necessary capital improvements within this limitation. In recognition of the severe financial bind that this limitation creates, its scope has been narrowed considerably by the courts by interpreting debt to mean only tax based indebtedness and by refusing to make the two percent cumulative, i.e., all municipal corporations are independently bound by the limit even though the same property may be included in more than one unit (see *Follett vs. Sheldon*, 144 N.E. 867 (Ind. 1924)). Because of this narrow interpretation, the legislature has created a variety of other financing methods designed to give municipalities and other municipal corporations ways to finance capital improvements that are not subject to the constitutional limitation.

Special Taxing Districts

One category of financing that does not count against a municipality's two percent constitutional debt limitation has been provided through legislative authorization for the creation of special taxing districts. These bonds are known as special taxing district bonds and are payable from a property tax levied outside the levy limitations in a special taxing district. Some of the purposes for which these bonds may be used include:

- flood control (IC 36-9-29-23);
- sanitation (IC 36-9-25-27;
- thoroughfares (IC 36-9-6.1-11);
- parks (IC 36-10-3-24 and 36-10-4-35);
- redevelopment (IC 36-7-14 and IC 36-7-15.1); and
- waterworks (IC 8-1.5-4).

However, not all municipalities may use all special taxing district statutes. Bonds issued by special taxing districts are not subject to the municipality's two percent constitutional debt limitation because they are not considered obligations of the municipality but of the property and persons within the district. Special taxing districts are given the power to levy special benefits taxes based on the value of property (except for improvement districts), issue bonds up to the statutory debt limits set by the particular authorizing statute, and deposit taxes in special funds for the payment of obligations. Generally, the municipality creating the special taxing district may also issue general obligation bonds to provide financing for the tax district to carry out its functions within the

municipality (IC 36-4-6-19), but the bonds are subject to the municipality's own two percent constitutional debt limitation.

Advantages of this method of financing lie in its broad application to many activities and the ease with which such a system provides for the collection of tax dollars.

There are several disadvantages to the use of special taxing districts to finance certain activities. One is that separate boards (appointed by elected officials) are required, which may mean a loss of direct control over the function by the municipal government. Another disadvantage results from this method's mechanism for financing an improvement by taxation based on the value of property. (See discussion under Special Obligation Bonds.)

Another disadvantage of special taxing district bonds is the lengthy procedures the issuer must follow and the risk that, after completing these lengthy procedures, the bonds cannot be issued. These procedures are described under "General Obligation Bonds" above. The Circuit Breaker Tax Credit also adversely affects the marketability of this type of bonds.

Special Obligation Bonds

Special obligation bonds backed by the levy of special assessments are used to finance many kinds of improvements that are made for the benefit of a particular group of persons (e.g. a neighborhood). But, the fact that a municipality has the power to make an improvement that will benefit only a part of the community does not mean it can use the special assessment process to finance the project.

To levy a special assessment a municipality must have express statutory authority. This authority has been given for improvements such as sidewalks, curbs, streets, alleys, pedestrian malls, other paved public places, parking facilities, lighting, electric signals, landscaping and sewers. These special assessments come under a category known as Barrett Law Assessments (IC 36-9-36, 36-9-37, 36-9-38 and 36-9-39).

Special obligation bonds based on the use of special assessments avoid the constitutional debt limit discussed earlier because the obligation created under this method of financing is not a liability of the municipality, but of the beneficiary of the improvement. However, the lien of a special assessment is not against the owner of the property, but is against the property itself; and only the assessed property is liable to satisfy the assessment lien. Agricultural lands, church property and railroad property have been held liable for assessments, but with respect to public property there have been conflicting court decisions.

Where the cost of an improvement exceeds the special benefits resulting to the several parcels of property in an assessment area, the improvement itself, and the excess cost must be borne by the municipality.

Two advantages of this method of financing municipal improvements are to be stressed. First, it spreads costs in a manner that bears some relationship to the benefits received. Property owners in an area benefiting from an improvement pay its costs and are assessed without regard to the assessed value of their lots. Since owners of undeveloped lots stand to benefit as much by an improvement as those owning the more expensive lots, it is more equitable when they pay at the same rate. Secondly, special assessment bonds may be issued without going through the difficult approval process applicable to general obligation bonds and special taxing district bonds.

The major disadvantage of special assessments is that the process of assessing property, financing these projects and administering the collections is expensive and time consuming. In addition, this type of bond is generally less marketable than tax based or revenue bonds. Because of these issues, special obligation bonds are rare.

Revenue Bonds

Revenue bonds are also authorized by statute for certain specific purposes. They require the expectation of continuing income to eventually be generated by the facility or operation to be financed or some other revenue stream and the bond is a claim only against such revenue. Municipal utility bonds are usually of this type. Revenue bonds are generally not subject to the constitutional debt limit. Revenue bonds, as the name implies, are repaid from the revenues of the facilities or systems built, in whole or in part, through the use of the bond proceeds. Revenues are deposited in special funds separate from the general fund of the municipality.

Purposes for which revenue bonds are used include parking facilities (IC 36-9-11-16), sewers (IC 36-9-23 and 36-9-25), swimming pools, skating rinks and golf courses (IC 36-10-5-3), solid waste disposal facilities (IC 36-9-30-17), waterworks (IC 8-1.5-4-12), water, gas and electric utilities (IC 8-1.5-1), economic development (IC 36-7-12) and redevelopment projects (IC 36-7-14-25.1). Facilities may be purchased, built or improved by issuing bonds to be paid off with their own revenues and earnings, and not from the general fund of the municipality. These bonds are, in effect, self-liquidating with no tax levy necessary to retire them. Certain types of revenue

bonds may be coupled with property tax revenues to pay or guarantee debt service. The dollar amount that may be financed by revenue bonds is limited only by the ability of the facility financed to raise revenues. Investors will buy these bonds as long as the project involved is financially feasible.

The advantage of this method is that it may be the most equitable basis of payment (people pay according to their use). The disadvantage is that it is limited to projects that produce revenue. While revenue bonds may not be as marketable as tax based bonds, there is a ready market for municipal utility revenue bonds in Indiana. Additionally, if the bond issue is for a utility regulated by the Indiana Utility Regulatory Commission, approval of the Commission for the bond issue is required.

Revenue bonds to finance facilities such as sewer or electric, which require mandatory public use of the facility, are more marketable and can obtain a lower interest rate than revenue bonds for such projects as parking or recreational use which the public makes use of on a strictly voluntary basis.

Tax Increment Financing

Municipalities may use tax increment financing (TIF) for the financing of capital improvement projects in areas needing redevelopment or in economic development areas. TIF is a different form of special taxing district financing and its use has grown considerably among cities and towns. In TIF financings, a portion of the redevelopment district is designated as either an area in need of redevelopment or an economic development area, and then as a TIF allocation area. The list of eligible projects that can be financed through TIF is lengthy and includes most capital projects intended to eliminate blight or enhance redevelopment or economic development.

Unlike special taxing districts, TIF financings do not involve the imposition of new or additional property taxes. Instead, the additional revenues required to finance the new projects are derived from the growth of assessed valuation that occurs once the improvements are in place. Growth in real property assessed value in the designated area is captured. In some cases, growth of depreciable personal property assessed value may be captured. The tax increment revenue that is generated by applying, with minor exceptions, the total cumulative tax rate (the tax rates of all taxing units in the designated area) to this increase in the assessed valuation is dedicated to the TIF area and can be used to repay the debt incurred to finance the new project.

Tax increment financing is also available for military base reuse authorities, airport development zones and certified technology parks. Each of these types of TIF areas has specific, detailed requirements and a municipality should contact competent legal counsel for advice on them.

The marketability of TIF bonds is determined by the certainty of growth in assessed valuation. Consequently, TIF bonds may not be an appropriate means of financing projects when growth is only speculative. Instead, development often needs to be underway and certain before pure TIF financing is feasible or a backup revenue source may have to be committed to guaranty that bondholders will be paid. Backup sources include property taxes, income taxes, project revenues and taxpayer guarantees. Many TIF bonds have some kind of backup security.

Special Purpose Corporations

Special purpose corporations are similar to special taxing districts because they necessitate the creation of a separate unit of government to carry out what might otherwise be a function of the municipality itself. They differ from special taxing districts because they are treated as independent municipal corporations with, in some cases, their own bonding powers of up to two percent of their adjusted value of taxable property. Also, their boundaries are often coterminous with those of the municipality.

The legislature has authorized the creation of special purpose corporations to assume responsibility for hospitals (IC 5-1-4), libraries (IC 20-13-1), public transportation (IC 36-9-4), airport authorities (IC 8-22-3), housing (IC 36-7-18), and in some cases, fire prevention (IC 36-8-11-17). The use of such financing authority varies among municipalities.

Bonding With Other Taxes

The legislature has authorized other taxes available to municipalities and other units of government, which may be used as a source of repayment for bond issues.

For municipalities, the most common tax (other than property taxes) for bond issues has been one of the three local option income taxes. There has been limited bonding using the County Adjusted Gross Income Tax (CAGIT) because most of CAGIT is dedicated to property tax relief. See Municipal Revenue Sources - Local Option Taxes. The County Option Income Tax (COIT) and the County Economic Development Income Tax

(CEDIT) are used frequently for bond financings. Like general obligation bonds, a city or town may issue bonds payable from CEDIT and COIT for any corporate purpose. Under current Indiana Supreme Court case law, CAGIT, COIT and CEDIT bonds most likely count against the two percent constitutional debt limitation.

Some municipalities may use food and beverage or innkeepers taxes to support bond issues. Most of this legislation is specific to a particular issuer and municipalities should consult the statutes about the ability to use these revenues to support debt. Municipalities should consult with their attorneys about the constitutionality of any statute that is specific to a particular community. Under current case law, bonds payable from these taxes most likely count against the two percent constitutional debt limit.

Lease-Rental Arrangements

The use of lease-rental arrangements is a type of financing which, if properly structured, does not count against the two percent constitutional debt limitation. A leased facility is not purchased by the municipality itself, but rather its use is contracted for under a lease. The long-term obligation created by a properly drafted lease is deemed by the courts not to be a debt as defined in the constitutional limitation (See *Teperich vs. North Judson-San Pierre*, 275 N.E.2d 814 (Ind. 1971)). IC 36-1-10 gives municipalities the power to lease a building, computer system, parking facility or some transportation projects either alone or with other units of government from any corporation organized under state law or licensed to do business in the state. The contract for lease may be made prior to construction of the premises to be leased, but may not exceed a period of 50 years. Most of these leases contain an option to purchase.

Under IC 36-1-10, before a municipality enters into a contract or lease, a petition signed by 50 or more taxpayers must be filed stating a need exists for such a project. The municipality must publish notice of the proposed lease arrangement, hold a public hearing and then authorize the lease by action of the common council or town council. Following execution of the lease, a notice must be published. If ten or more taxpayers object to the lease as unnecessary, or as providing for unreasonable rental, the DLGF is required to hold a hearing and make a final decision whether to permit the lease arrangement.

The petition and remonstrance process or referendum process also applies to a lease entered into to finance a controlled project. See "General Obligation Bonds" above for a discussion of the impact of the Circuit Breaker Tax Credit.

IC 36-1-10 provides for a tax levy to pay lease rentals, but municipalities should know that lease-rental arrangements are not limited to property tax repayment. In virtually all of the bond issues mentioned earlier that would be subject to the two percent constitutional debt limitation, the lease-rental arrangement bypasses this limitation. This includes lease rental arrangements not only where repayment comes from property taxes, but also income taxes, food and beverage taxes and innkeeper's taxes.

There are also some specific statutes authorizing the leasing of facilities for certain municipal functions, such as sewage disposal facilities (IC 36-9-24) and buses (IC 36-9-4).

Municipalities may undertake lease financings under several other statutes, including the city-county building authority statute (IC 36-9-13), the redevelopment authority statute (IC 36714.5) and the CEDIT statute (IC 6-3.5-7). Each of these financing alternatives has advantages and disadvantages depending on the particular local situation and project to be financed.

It should be noted that if done correctly, this method of financing does not usually jeopardize the tax exempt status of the borrowing.

Refunding Bonds

Refunding bonds are not a method to finance new capital improvements, but are used to refinance bonds a municipality already has outstanding. A municipality may want to refinance its outstanding bonds if interest rates drop significantly and through such a reduction can lower its annual payments or shorten the term of the financing. Another reason a municipality may want to refinance outstanding bonds is that if revenues are less than projected, a refunding can lower annual payments by extending or lengthening the repayment period. However, bonds payable from property taxes, special benefits taxes or tax increment revenues that are issued to refinance outstanding bonds may not extend the repayment period beyond the maximum term of the bonds being refinanced.

Many municipalities have issued refunding bonds to eliminate restrictive or unnecessary bond covenants. Through a refunding, many restrictive covenants can be removed.

The authority to issue refunding bonds by municipalities and their political subdivisions is contained in IC

5-1-5 and many other specific statutes. It should be noted that the issuance of tax-exempt refunding bonds is also regulated by federal tax law. An advance refunding is a refunding where the new bonds are issued a minimum of ninety days prior to the time that the old bonds can be repaid so that both bond issues are technically outstanding for a time. Most advance refundings are structured to remove the municipality's liability for the refunded bonds. Generally, bond issuers are limited to only one tax-exempt advance refunding bond issue for each original bond.

Refunding bonds are generally of the same character and nature of the bonds that they replace. It should be noted that while a refunding does not necessarily extinguish the old bond issue, if done correctly, only the new issue counts towards the two percent constitutional debt limitation if the issue is subject to the limitation.

GENERAL PROCEDURES FOR ISSUING AND SELLING BONDS

Issuing and Selling Bonds

As the preceding information indicates, the process of issuing and selling bonds can be complicated and time consuming. Not only is the issuance of bonds highly regulated by state law, but because of the tax exempt status of municipal bonds and the fact that they are typically traded in the securities market, the federal tax code and federal securities laws also must be followed in the issuance of bonds.

The municipal executive and legislative bodies have a considerable amount of assistance they can call upon when contemplating the issuance of bonds or the borrowing of money.

The city or town attorney should be familiar with the basic procedures involved in the issuance of bonds and will represent the municipality in the transaction. Due to the complicated legal nature of issuing bonds, some law firms specialize in this area. Termed "bond counsel," these firms are knowledgeable about the state law issues, federal and state tax law issues and federal security law issues. While the municipal attorney must give an opinion that all state requirements and procedures have been properly followed, bond counsel generally must give an opinion that the bonds or lease is valid and that the bonds are tax exempt. Experienced bond counsel can assist the municipality in selecting the most appropriate form of financing and help the municipality follow all pertinent statutes and regulations. In addition, bond counsel will prepare most of the documents required for the bond issue. Almost all bond purchasers require an opinion of nationally recognized bond counsel.

It is also apparent that in many bond issues, the financial expertise required in projecting revenues, estimating utility rate requirements and mapping cash flows may exceed what is normally required of the municipal finance officer. Again, a specialized professional has evolved to provide this service to the municipality. Financial advisors can provide this type of service to the municipality as well as assist in the preparation of the documents required for the bond issue.

Federal securities law requires issuers of most publicly sold bonds to disclose information about the bonds and the issuer's finances to prospective bondholders when the bonds are issued. Also, in most cases, issuers of publicly sold bonds will be required to provide annual financial information and information about certain material events to the bond markets throughout the term of the bonds. It is critical for municipalities to seek advice from bond counsel and financial advisors about these matters to protect the municipality's credit rating.

State law requires that some types of bond issues must be sold competitively. In that case, the bonds are sold at a public sale to an underwriter or financial institution that offers the lowest net interest cost to the municipality. In this situation, the bond counsel and financial advisor, in conjunction with the municipality, prepare all of the documents prior to the actual sale of the bonds.

State law provides that some bond issues can be sold at a negotiated sale. Instead of auctioning the bonds, an underwriter is involved in the preliminary stages of the bond issue and assists in the development of the financing program as well as in the preparation of the documents. A negotiated sale is appropriate and sometimes necessary when the financing is particularly complicated, too large for the public sale or when the actual interest rates must be known before the sale can be completed. One example of this is an advance refunding bond, where the actual size of the bond issue cannot be determined until the net interest costs of the bond and the costs of repaying the old bond issue are known.

The municipality's financial advisor will give insight into choosing competitive versus negotiated sale when both options legally exist.

The purpose of the Indiana Bond Bank (IC 5-1.5) is to assist political subdivisions of the state through the pooling of bond issues and through the creation of special programs to address local government borrowing needs. Through the pooling of issues, local governments, particularly small local governments, may be able to

